

103^D CONGRESS
2^D SESSION

S. 1787

To amend the Internal Revenue Code of 1986 to provide for the tax-free treatment of education savings accounts established through certain State programs, and for other purposes.

IN THE SENATE OF THE UNITED STATES

JANUARY 25, 1994

Mr. McCONNELL introduced the following bill; which was read twice and referred to the Committee on Finance

A BILL

To amend the Internal Revenue Code of 1986 to provide for the tax-free treatment of education savings accounts established through certain State programs, and for other purposes.

1 *Be it enacted by the Senate and House of Representa-*
2 *tives of the United States of America in Congress assembled,*

3 **SECTION 1. TAX TREATMENT OF STATE EDUCATION SAV-**
4 **INGS ACCOUNTS.**

5 (a) IN GENERAL.—Part III of subchapter B of chap-
6 ter 1 of the Internal Revenue Code of 1986 (relating to
7 items specifically excluded from gross income) is amended

1 by redesignating section 137 as section 138 and by adding
2 after section 136 the following new section:

3 **“SEC. 137. EDUCATION SAVINGS ACCOUNTS.**

4 “(a) GENERAL RULE.—Gross income shall not in-
5 clude any qualified education savings account distribution.

6 “(b) QUALIFIED EDUCATION SAVINGS ACCOUNT
7 DISTRIBUTION.—For purposes of this section—

8 “(1) IN GENERAL.—The term ‘qualified edu-
9 cation savings account distribution’ means any
10 amount paid or distributed out of an education sav-
11 ings account which would otherwise be includible in
12 gross income to the extent such payment or distribu-
13 tion is used exclusively to pay qualified higher edu-
14 cation expenses incurred by the designated bene-
15 ficiary of the account.

16 “(2) ROLLOVERS.—The term ‘qualified edu-
17 cation savings account distribution’ includes any
18 transfer from an education savings account of one
19 designated beneficiary to another such account of
20 such beneficiary or to such an account of another
21 designated beneficiary.

22 “(3) SPECIAL RULES.—The determination
23 under paragraph (1) as to whether an amount is
24 otherwise includible in gross income shall be made in
25 the manner described in section 72, except that—

1 “(A) all education savings accounts shall
2 be treated as one contract,

3 “(B) all distributions during any taxable
4 year shall be treated as one distribution,

5 “(C) contributions to an account described
6 in subsection (c)(4)(B)(i) shall not be included
7 in the investment in the contract with respect
8 to the account, and

9 “(D) the value of the contract, income on
10 the contract, and investment in the contract
11 shall be computed as of the close of the cal-
12 endar year in which the taxable year begins.

13 “(c) EDUCATION SAVINGS ACCOUNT.—For purposes
14 of this section—

15 “(1) IN GENERAL.—The term ‘education sav-
16 ings account’ means a trust created or organized in
17 the United States—

18 “(A) pursuant to a qualified State edu-
19 cational savings plan, and

20 “(B) exclusively for the purpose of paying
21 the qualified higher education expenses of the
22 designated beneficiary of the account.

23 “(2) QUALIFIED STATE EDUCATIONAL SAVINGS
24 PLAN.—The term ‘qualified State educational sav-

1 ings plan’ means a plan established and maintained
2 by a State or instrumentality thereof under which—

3 “(A) participants may save to meet quali-
4 fied higher education expenses of designated
5 beneficiaries,

6 “(B) planning and financial information is
7 provided to participants about current and pro-
8 jected qualified higher education expenses,

9 “(C) education savings account statements
10 are provided to participants at least quarterly,
11 and

12 “(D) an audited financial statement is pro-
13 vided to participants at least annually.

14 “(3) QUALIFIED HIGHER EDUCATION EX-
15 PENSES.—The term ‘qualified higher education ex-
16 penses’ means the cost of attendance (as defined in
17 section 472 of the Higher Education Act of 1965).

18 “(4) LIMITATIONS.—A trust shall not be treat-
19 ed as an education savings account unless the follow-
20 ing requirements are met:

21 “(A) No contribution will be accepted un-
22 less it is in cash, stocks, bonds, or other securi-
23 ties which are readily tradable on an established
24 securities market.

1 “(B) Contributions will not be accepted for
2 any taxable year in excess of the applicable
3 limit. The preceding sentence shall not apply
4 to—

5 “(i) contributions to the qualified
6 State educational savings plan which are
7 allocated to all education savings accounts
8 within the class for which the contribution
9 was made, or

10 “(ii) rollover contributions described
11 in subsection (b)(2).

12 “(C) The trust may not be established for
13 the benefit of more than one individual.

14 “(D) The trustee is the qualified State
15 educational savings plan or person designated
16 by it.

17 “(E) The assets of the trust may be in-
18 vested only in accordance with the qualified
19 State educational savings plan.

20 “(5) APPLICABLE LIMIT.—For purposes of
21 paragraph (4)(B)—

22 “(A) IN GENERAL.—The applicable limit is
23 \$3,000.

24 “(B) INDEXING.—In the case of taxable
25 years beginning after December 31, 1995, the

1 \$3,000 amount under subparagraph (A) shall
2 be increased by the education cost-of-living ad-
3 justment for the calendar year in which the tax-
4 able year begins.

5 “(C) EDUCATION COST-OF-LIVING ADJUST-
6 MENT.—For purposes of subparagraph (B), the
7 education cost-of-living adjustment for any cal-
8 endar year is the percentage (if any) by
9 which—

10 “(i) the higher education cost index
11 for the preceding calendar year, exceeds

12 “(ii) such index for 1994.

13 “(D) HIGHER EDUCATION COST INDEX.—
14 For purposes of subparagraph (C), the higher
15 education cost index for any calendar year is
16 the average qualified higher education expenses
17 for undergraduate students at both private and
18 public institutions of higher education for the
19 12-month period ending on August 31 of the
20 calendar year. The Secretary of Education shall
21 provide for the computation and publication of
22 the higher education cost index.

23 “(d) TAX TREATMENT OF ACCOUNTS AND STATE
24 PLANS.—

1 “(1) EXEMPTION FROM TAX.—An education
2 savings account shall be exempt from taxation under
3 this subtitle. Notwithstanding the preceding sen-
4 tence, any such account or plan shall be subject to
5 the taxes imposed by section 511 (relating to imposi-
6 tion of tax on unrelated business income of chari-
7 table, etc. organizations).

8 “(2) LOSS OF EXEMPTION OF ACCOUNT WHERE
9 INDIVIDUAL ENGAGES IN PROHIBITED TRANS-
10 ACTION.—

11 “(A) IN GENERAL.—If the designated ben-
12 eficiary of an education savings account is es-
13 tablished or any individual who contributes to
14 such account engages in any transaction prohib-
15 ited by section 4975 with respect to the ac-
16 count, the account shall cease to be an edu-
17 cation savings account as of the first day of the
18 taxable year (of the individual so engaging in
19 such transaction) during which such transaction
20 occurs.

21 “(B) ACCOUNT TREATED AS DISTRIBUTING
22 ALL ITS ASSETS.—In any case in which any ac-
23 count ceases to be an education savings account
24 by reason of subparagraph (A) as of the first
25 day of any taxable year, an amount equal to the

1 fair market value of all assets in the account
2 shall be treated as having been distributed on
3 such first day.

4 “(3) EFFECT OF PLEDGING ACCOUNT AS SECUR-
5 RITY.—If, during any taxable year, the individual for
6 whose benefit an education savings account is estab-
7 lished, or any individual who contributes to such ac-
8 count, uses the account or any portion thereof as se-
9 curity for a loan, the portion so used shall be treated
10 as distributed to the individual so using such por-
11 tion.

12 “(e) REPORTS.—The Secretary may require the
13 trustee of an education savings account to make reports
14 regarding such account to the Secretary, to the individual
15 who has established the account, and to the designated
16 beneficiary of the account with respect to contributions,
17 distributions, and such other matters as the Secretary
18 may require. The reports required by this subsection shall
19 be filed at such time and in such manner and furnished
20 to such individuals at such time and in such manner as
21 may be required by those regulations.”

22 (b) TAX TREATMENT OF QUALIFIED STATE EDU-
23 CATIONAL SAVINGS PLAN.—

24 (1) TREATMENT AS SECTION 501(C)(3) ORGANI-
25 ZATION.—Section 501(c)(3) of such Code is amend-

1 ed by inserting “or which is a qualified State edu-
 2 cational savings plan (as defined in section
 3 137(c)(2)),” after “animals,”.

4 (2) CHARITABLE CONTRIBUTIONS.—

5 (A) Subparagraph (B) of section 170(c)(2)
 6 of such Code is amended by inserting “, or
 7 which is a qualified State educational savings
 8 plan (as defined in section 137(c)(2)),” after
 9 “animals”.

10 (B) Section 170(b)(1)(A) of such Code is
 11 amended by striking “or” at the end of clause
 12 (vii), by inserting “or” at the end of clause
 13 (viii) and by inserting after clause (viii) the fol-
 14 lowing new clause:

15 “(ix) a qualified State educational
 16 savings plan (as defined in section
 17 137(c)(2)).”

18 (c) CONTRIBUTION NOT SUBJECT TO GIFT TAX.—
 19 Section 2503 of such Code (relating to taxable gifts) is
 20 amended by adding at the end thereof the following new
 21 subsection:

22 “(h) EDUCATION SAVINGS ACCOUNTS.—Any con-
 23 tribution made by an individual to an education savings
 24 account described in section 137 shall not be treated as

1 a transfer of property by gift for purposes of this chap-
2 ter.”

3 (d) TAX ON PROHIBITED TRANSACTIONS.—Section
4 4975 of such Code (relating to prohibited transactions)
5 is amended—

6 (1) by adding at the end of subsection (c) the
7 following new paragraph:

8 “(4) SPECIAL RULE FOR EDUCATION SAVINGS
9 ACCOUNTS.—An individual for whose benefit an edu-
10 cation savings account is established and any con-
11 tributor to such account shall be exempt from the
12 tax imposed by this section with respect to any
13 transaction concerning such account (which would
14 otherwise be taxable under this section) if, with re-
15 spect to such transaction, the account ceases to be
16 an education savings account by reason of the appli-
17 cation of section 137(d)(2)(A) to such account.”,
18 and

19 (2) by inserting “, an education savings account
20 described in section 137(c),” in subsection (e)(1)
21 after “described in section 408(a)”.

22 (e) FAILURE TO PROVIDE REPORTS ON EDUCATION
23 SAVINGS ACCOUNTS.—Section 6693 of such Code (relat-
24 ing to failure to provide reports on individual retirement
25 accounts or annuities) is amended—

1 (1) by inserting “**OR ON EDUCATION SAV-**
2 **INGS ACCOUNTS**” after “**ANNUITIES**” in the
3 heading of such section, and

4 (2) by adding at the end of subsection (a) the
5 following new sentence: “Any person required by
6 section 137(e) to file a report regarding an edu-
7 cation savings account who fails to file the report at
8 the time or in the manner required by such section
9 shall pay a penalty of \$50 for each failure, unless
10 it is shown that such failure is due to reasonable
11 cause.”

12 (f) SPECIAL RULE FOR DETERMINING AMOUNTS OF
13 SUPPORT FOR DEPENDENT.—Subsection (b) of section
14 152 of such Code (relating to definition of dependent) is
15 amended by adding at the end the following new para-
16 graph:

17 “(6) A distribution from an education savings
18 account described in section 137(c) to the individual
19 for whose benefit such account has been established
20 shall not be taken into account in determining sup-
21 port for purposes of this section to the extent such
22 distribution is excluded from gross income of such
23 individual under section 137.”

24 (g) CLERICAL AMENDMENTS.—

1 (1) The table of sections for part III of sub-
2 chapter B of chapter 1 of such Code is amended by
3 striking out the item relating to section 137 and in-
4 serting the following new items:

 “Sec. 137. Education savings accounts.
 “Sec. 138. Cross references to other Acts.”

5 (2) The table of sections for subchapter B of
6 chapter 68 of such Code is amended by striking out
7 the item relating to section 6693 and inserting the
8 following new item:

 “Sec. 6693. Failure to provide reports on individual retirement
 accounts or annuities or on education savings ac-
 counts.”

9 (h) EFFECTIVE DATE.—The amendments made by
10 this section shall apply to contributions made in taxable
11 years beginning after December 31, 1994.

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